DUPLICATE

Before the
Federal Communications Commission
Washington, D.C. 20554

JUN 16 1994

In the Matter of	)	
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Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation	)	MM Docket No. 93-215
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

RESPONSE OF CONTINENTAL CABLEVISION INC., BENCHMARK COMMUNICATIONS, L.P., AND CABLESOUTH, INC., TO PETITIONS FOR RECONSIDERATION OF COMCAST CABLE COMMUNICATIONS, INC., ET AL.

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AND CABLESOUTH, INC.

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TABLE OF CONTENTS

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RECEIVED
JUN 1 6 1994

In the Matter of	)	
	)	
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The undersigned cable operators[1] oppose the Petition for Reconsideration filed by Bell Atlantic and support the Petitions filed by Public Interest Petitioners, Comcast Cable Communications, Inc., Cablevision Industries, Inc., and Media General Cable.[2]

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[1] Continental is the third largest multiple system operator in the United States and serves nearly 3 million basic subscribers. Benchmark Communications, L.P. and CableSouth, Inc. are smaller MSOs with approximately 68,000 subscribers, and 29,000 subscribers, respectively. Each of the undersigned operators has one or more cost-of-service proceedings pending at the Commission and/or before local franchising authorities.

[2] The undersigned cable operators also support the Petition for Reconsideration of Bend Cable Communications, Inc., ***et al.***, but do not discuss here, the issues raised by that Petition.

SUMMARY

The interim cost-of-service rules[3] establish a presumption that virtually all intangible assets recorded in connection with the acquisition of a cable system must be excluded from the rate base. This presumption unreasonably deprives cable operators of their right to a return on capital prudently invested in the cable enterprise. The Commission should accept the suggestions of Comcast and Cablevision Industries to eliminate the presumption entirely. If, however, the presumption is to be retained in some form, it must be substantially revised to conform to the Commission's benchmark analysis and the realities of cable system financing. Specifically, in light of the direct relationship between cable system cash flow and acquisition prices, the only presumption regarding acquisition intangibles that comports with the benchmark analysis is a presumption that 66% of the price paid for a system be presumptively ***included*** in the rate base.

Public Interest Petitioners correctly point out that the Commission's rate regulation rules do not give adequate consideration to statutory mandates other than low rates, including programming diversity and system growth and expansion. Public Interest Petitioners also correctly note that there are significant First Amendment overtones to the Commission's approach to rate regulation. These factors lead to the conclusion that, in evaluating cable system rates under cost-of-service principles, the Commission's objective

[3] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, ***Report and Order and Further Notice of Proposed Rulemaking,*** MM Docket 93-215, FCC 94-39 (released March 30, 1994) (***"Cost of Service Order"***).

should be to establish the highest rate for cable services that is still within the "zone of reasonableness."

Finally, Bell Atlantic continues its disingenuous pursuit of "regulatory parity" by identifying two features of cable rate regulation that it claims are unfair when compared to the treatment telephone companies receive. The differing legal, business and economic realities of the cable and telephone industries, however, demonstrate that Bell Atlantic's request for reconsideration should be rejected.

DISCUSSION

I. THE COMMISSION'S PRESUMPTION AGAINST THE INCLUSION OF ACQUISITION-RELATED INTANGIBLES SHOULD BE REVISED OR ELIMINATED.

A. The Presumption Against Acquisition Intangibles Should Be Substantially Revised To Reflect The Commission's Benchmark Analysis And The Realities Of Cable System Financing.

The presumption against acquisition-related intangibles embodied in the interim cost-of-service rules must be substantially revised. The reason is that the current presumption is far more oppressive to cable operators than the rationale for the presumption would support. In these circumstances, the presumption is subject to reversal on appeal and should be reconsidered.[4]

[4] *See Mountain States Tel. & Tel. Co. v. FCC,* 939 F.2d 1021 (D.C. Cir. 1991); *Mountain States Tel. & Tel. Co. v. FCC,* 939 F.2d 1035 (D.C. Cir. 1991).

The stated basis for the presumption against including acquisition-related intangibles in the rate base is a concern that such assets represent capitalized monopoly profits.[5] A consideration of the Commission's own benchmark analysis, however, combined with some basic facts regarding cable system financing and acquisitions, shows that the presumption needs to be significantly revised if it is to accurately reflect that purpose. Specifically, as described below, the 17% revenue reduction in the FCC's new benchmark system would support a maximum disallowance of acquisition intangibles equal to approximately 34% of the gross purchase price of the system. The remaining 66% of the price, comprising both tangible and intangible assets, should presumptively be included in the rate base.

Cable system financing is vitally dependent upon cash flow, which is, simply, revenues minus operating expenses, not including depreciation or amortization. Cash flow provides the basis of the cable system to repay interest on debt obtained in order to purchase it, and is the primary, if not exclusive, source of funds from which a cable operator may upgrade the system itself. For these reasons, when a cable system is sold, the selling price is typically calculated and negotiated as a multiple of cash flow.[6]

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[5] ***Cost-of-Service Order*** at ¶91. The Order also expresses some concern that acquisition prices might also reflect anticipated earnings from non-regulated activities. ***Id.*** at ¶92. This latter concern, however, does not warrant any ***disallowance*** of intangible assets. It simply means that care must be taken in allocating the overall rate base among regulated and unregulated activities.

[6] ***See*** Declaration of Colleen Millsap, (attached). Factors which affect the precise ***multiple*** of cash flow for which a system will sell include the buyer's view of operational efficiencies and improvements that could be added to the system and the likelihood of significant growth in the subscriber base that the buyer anticipates (whether through population growth, additional system build-out, or improved marketing and service). ***Id.***

While the circumstances of each individual system will vary somewhat, on average, a cable system's operating revenues generally are about twice operating expenses. As a matter of arithmetic, this means that cash flow is about one-half of revenues. In these circumstances, an "exogenous" decrease in revenues, not accompanied by a decline in operating costs (*e.g.,* a rate decrease ordered by a regulator) will result in a dollar-for-dollar decline in cash flow. In percentage terms, therefore, each 1% revenue reduction leads to a 2% reduction in cash flow:[7]

Item	Before	After	% Change
Revenue	$100	$99	-1%
Operating Expenses	$ 50	$50	0%
Cash Flow	$ 50	$49	-2%

It follows that, if the FCC is correct that 17% of cable operator revenue represents monopoly profits, then 34% -- but no more than 34% -- of cable operator cash flow is similarly "tainted." In the case of a cable company acquisition, therefore, because purchase price is based directly on cash flow, 34% of the purchase price --- but no more than 34% -- arguably represents monopoly profits as well.[8]

[7] *Id.*

[8] Undersigned cable operators do not believe that the FCC has correctly calculated the level of price reduction required to remove purported monopoly profits from cable operators' prices. To the contrary, we believe that the FCC's ***previous*** 10% rate reduction was excessive. The point here, however, is that whatever is ultimately settled upon as an appropriate average benchmark reduction, that number is directly linked to the proportion of acquisition price that should be viewed as "tainted" with monopoly profits, in an approximate 1:2 ratio.

In these circumstances, the ***only*** presumption regarding acquisition intangibles that is consistent with the Commission's "benchmark" analysis of monopoly profits in cable operator revenues is a presumption that cable operators should be allowed to include 66% of the price paid for a system in the asset base used for ratemaking purposes.[9] A presumptive allowance of less than this amount would be inconsistent with the initial rationale for the presumption in the first place.[10]

B. The Commission Should Also Revise Its Presumption Regarding Start-Up Losses and Low Earnings.

Media General explains that, while the Commission correctly recognized that some allowance should be made in rate base for start-up losses and low earnings, the Commission incorrectly assumed that amounts a cable operator may have capitalized under Statement of Financial Accounting Standards No. 51 (SFAS-51) provides a reasonable measure of the amount that should be allowed into rate base.[11] The Commission should accept Media General's conclusion.

Amounts capitalized under SFAS-51 will not accurately reflect the amounts invested by the original operator of the system, and, therefore, should not be relied upon for this

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[9] Of course, operators would be permitted to show in individual cases that an even larger proportion of purchase price should be included in the ratebase.

[10] ***See Mountain States Tel. & Tel., supra.*** The Commission should also consider adopting, on reconsideration, the approach discussed in the ***Cost of Service Order*** of allowing operators to amortize, but not include in rate base, investments that, while made in good faith under the circumstances existing at the time, are nonetheless disallowed for policy reasons.

[11] Media General Petition at 2-9.

purpose. SFAS-51 presumes that the correct period for assessing the entity's earnings is a single calendar year, and generally respects the rule that, once revenue is derived from a system, ongoing expenses should be treated as such, rather than capitalized. SFAS-51, however, recognizes a limited exception to that rule where a cable system is largely still under construction, but some revenues are being received from some customers. In that case, a portion of the expenses relating to the operation of the system can be capitalized, rather than expensed in the period incurred, in order to reflect the fact that they properly relate to the services that will be provided to future customers during future periods. This limited accounting rule was never intended to address the question of whether investors in cable systems will obtain reasonable earnings from their investment over the life of the system, and, as a result, has only tangential relevance to the problem of recognizing the true amount of investment in a cable system.

The real problem at hand is that -- unlike typical regulated utilities -- cable systems do not produce regular returns over the course of their useful life. Quite the contrary: a typical cable system operates at a loss or with extremely low book earnings for a number of years, then at high "book" earnings levels for a number of years more.[12] Investors in

[12] ***See*** Declaration of Colleen Millsap, attached. ***See also*** In the Matter of New England Cable News, ***Memorandum Opinion and Order***, Docket CSR-4190-P, FCC 94-133, ¶ 35 (released June 1, 1994). In the FCC's rulemaking proceeding regarding cost-of-service issues, Continental Cablevision submitted an analysis comparing its actual investment -- including foregone earnings -- in a system it had built and operated from inception, and the price it paid for an otherwise generally similar system it acquired much later in the system's life-cycle. ***Comments of Continental Cablevision***, MM Docket No. 93-215 (August 25, 1993) at 14-25. The amount of intangibles at issue in each case, determined using the two different approaches, was very similar, thus demonstrating that a market-based purchase price will approximate the actual investment of the original owner.

cable systems understand this economic reality and invest for the long term, expecting that the losses and low earnings in earlier years will be made up by higher earnings in later years. Over the long term, expected earnings are not out of line with other investments of comparable risk; but except for a few years in the middle of the system's life cycle, annual "book" returns will be either well above or well below a "reasonable" level.[13]

To deal with this situation, the losses and low earnings in early years should be regarded as additional investments in the enterprise and added to rate base. This will automatically lead to a situation where cable operator earnings in later years will be evaluated with the initial losses and low earnings taken into account.

The amount that should be added to rate base can be calculated by reference to financial records for earlier periods, if they are available. All earnings shortfalls below a reasonable level, including both actual losses and low, but non-negative, earnings, should be added to a rate base account established for this purpose.[14] Each subsequent year's earnings shortfall should be calculated, including cumulative prior year shortfalls in the investment base.[15] Finally, when earnings reach the stage that they exceed a reasonable

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[13] ***See*** Declaration of Colleen Millsap, attached.

[14] The FCC's interim 11.25% overall after-tax return can be used as a conservative estimate of a "reasonable" return level for these purposes. It is conservative because in the not-too-distant past, interest rates were much higher than current levels, and equity was more expensive as well. The 11.25% figure -- based on a current analysis by the FCC -- will, therefore, plainly understate the cost of capital in prior periods.

[15] This will automatically reflect the fact that there is a cost of money associated with leaving the losses and low earnings unrecovered in the business for a number of years.

level on a "book" basis, the excess over the reasonable level should be credited against the "accumulated losses/low earnings" account on a going-forward basis.[16]

The available precedent in the field of cable rate regulation supports allowing intangibles relating to early period losses and low earnings into rate base. For example, in 1977, during an earlier period of cable rate regulation, the Massachusetts Cable Television Commission held that:

> [O]perating losses are properly allowable in the rate base because they represent funds prudently invested in the construction and maintenance of the system at a time when the bulk of expenditures had to be made. ... A policy specifically prohibiting the opportunity to earn a return on these funds would jeopardize the economic viability of systems that have experienced substantial prior losses ... [and] might have a chilling effect on the development of cable in Massachusetts.

Stan-Fran Corp. in Haverhill and Groveland, Docket No. AFD-10, AFD 24 at 5 (Mass. Community Antenna Tel. Comm'n, Feb. 17, 1977).

More recently, a federal court in Illinois was confronted with the question of whether a cable operator's rates were "reasonable" under the rate regulation provisions of the 1984 Cable Act. The local franchising authority claimed that the cable system's high book earnings in recent years showed that current rates were too high. The court, however, disagreed, holding that "[t]he rate of return during these early years [of a cable system's life-cycle] is typically low or even negative. Years after the investment, however, returns

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[16] An alternative approach would be to calculate each year's earnings on a pure "book" basis, without recognition of prior period shortfalls, but to add a cost-of-money allowance to the cumulative shortfall each year. When "book" earnings exceed a reasonable level, the accumulated shortfall would be reduced by the excess until it reaches zero.

increase. The proper way to evaluate the reasonableness of rates is to incorporate into the analysis what happens in the earlier years." ***City of Ottawa, Illinois v. Sammons Communications,*** 836 F. Supp. 555, 561 (N.D. Ill. 1993).[17]

In these circumstances, the Commission should allow cable operators to include an intangible asset in the rate base, calculated as described above, to reflect the losses and low earnings the cable system has experienced. This procedure should be followed in all cases where adequate financial records exist, including those where the cable system has been purchased by another entity. Where financial records do not exist, then the Commission should, at a minimum, reconsider its presumption against acquisition intangibles, as described in Section I.A.

In fact, the Commission would be fully justified in totally eliminating the presumption against including intangible assets related to acquisitions, as well as start-up losses and low earnings.[18] Generally speaking, the price paid for a cable system will

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[17] Older precedent, not directly related to the cable industry, also supports including intangible assets in rate base. "The thing devoted by the [regulated company] investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon ***the capital so invested,*** the Federal Constitution guarantees to the [regulated company] an opportunity to earn a fair return." ***Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n,*** 262 U.S. 277, 290 (1922) (Brandeis, J., concurring) (emphasis added). In this regard, courts have noted that Justice Brandeis's "central idea that the investor's legally protected interest resides in the ***capital he invests*** in the [regulated firm] rather than the items of property which the capital purchases for provision of [regulated] service" has prevailed. ***Democratic Central Committee v. Washington Metro Area Transit Commission,***, 485 F.2d 786, 801 (D.C. Cir. 1973) (emphasis added). As noted above, in the case of cable systems with prolonged initial periods of losses and low earnings, the amount of capital actually invested in the system far exceeds the net book value of tangible assets recorded on the firm's books for accounting purposes.

[18] ***See*** Comcast Cable Communications, Inc., Petition for Reconsideration; Cablevision Industries, Inc., Petition for Reconsideration.

include a market valuation of losses and low earnings experienced by the original owner. The reason is that, when the original owner sells a system, it will demand compensation not only for the physical, tangible assets of the system, but also for the amount invested in the form of losses and foregone earnings. In arms-length transactions -- where the buyer has no interest in anything other than the lowest possible purchase price -- that purchase price will reflect the value of the ***actual*** investment by the prior owner in the system, including an allowance of a reasonable, if implicit, market-based return on that investment.[19]

II. THE COMMISSION SHOULD RECONSIDER ITS COST-OF-SERVICE RULES IN LIGHT OF PUBLIC INTEREST CONCERNS OTHER THAN THE LOWEST POSSIBLE RATES, AND IN LIGHT OF THE FIRST AMENDMENT.

Public Interest Petitioners correctly emphasize that the 1992 Cable Act was concerned with more than the lowest possible rates. Diversity of programming choices, technically advanced cable networks, and financially viable cable operators are all critically important goals of the statute.[20] The undersigned cable operators agree with Public Interest Petitioners that the Commission appears to have given inadequate weight to these other goals in devising its interim cost-of-service rules.

Public Interest Petitioners are also correct that the Commission's cost-of-service rules have serious First Amendment implications.[21] The provision of cable services is clearly

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[19] ***See*** note 10, ***supra.***

[20] ***See*** Public Interest Petitioners, Petition for Expedited Reconsideration at 6-8.

[21] Public Interest Petition at 13-14.

"speech" for purposes of the First Amendment,[22] and governmental price regulation "burdens" that speech.[23] Even assuming, as do Public Interest Petitioners, that cost-of-service regulation in and of itself is neutral as to content, the regulatory scheme must nonetheless be "narrowly tailored" to implement a significant governmental purpose.[24]

The cost-of-service rules announced by the Commission are not "narrowly tailored" to this end, particularly when considered in light of the other statutory purposes the Commission is charged with advancing here. The Commission's interim cost-of-service rules fail this test in at least three ways. First, those rules generally place the burden of proof of the reasonableness of rates on the cable operator. Second, they establish presumptions against the inclusion of millions of dollars of legitimate costs -- notably, the presumption against including intangible assets in rate base -- that operate against the interest of cable operators. Both of these features of the rule are foreclosed by ***Riley, supra***.[25] Finally, the purpose of rate regulation is fully met in the cost-of-service context by exercising all reasonable discretion in the cable operator's favor and establishing a rate

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22 ***Leathers v. Medlock,*** 499 U.S. 439, 444 (1991).

23 ***Riley v. National Federation of the Blind of North Carolina,*** 487 U.S. 781, 790 (1988).

24 ***See Ward v. Rock Against Racism,*** 491 U.S. 781, 789-90 (1989).

25 470 U.S. at 790. Indeed, even assuming that establishing reasonable rates for cable television service is a "significant" governmental interest for First Amendment purposes, it is questionable whether the specific regulatory approach the FCC has adopted can survive First Amendment scrutiny, because, as it now stands, the FCC's system for regulating cable rates is directly parallel in structure to the North Carolina system for regulating the rates charged by professional fundraisers that was struck down on its face in ***Riley, supra.*** The court in ***Daniels Cablevision, Inc., v. United States,*** 835 F. Supp. 1, 7 (D.D.C 1993), did not have the current set of rules and regulations available to it at the time it made its decision. It is questionable, therefore, whether the rationale of that decision will apply to the rules the Commission has actually adopted to implement the 1992 Act.

at the top of the zone of reasonableness. The highest reasonable rate is, by definition, a reasonable one that satisfies the purpose of the regulatory scheme. Any lower rate, therefore, would unnecessarily burden protected speech.

Moreover, the Commission's cost-of-service rules are not "content neutral." For example, those rules appear to contemplate that revenues from advertising placed on cable programming channels, and revenue from home shopping channels will be used to offset revenue requirements for regulated services.[26] This creates a strong disincentive to cable operators to offer these particular programs. In addition, a general rule that rates only may be increased based on cost creates an incentive to offer high cost, instead of low cost programming. These aspects of the cost-of-service rules raise significant First Amendment concerns.[27]

Finally, there is an inevitable conflict between the goals of low rates for customers and providing cable operators with the funds they need to offer new programming and expand their systems. The goals of the statute would be better harmonized by modifying the interim cost-of-service rules with an eye towards achieving, in each case, the ***highest***

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[26] ***See*** FCC Form 1220, at 14 ("Line 51 Advertising" and "Line 52 Other Cable Revenue Offsets").

[27] The best way to avoid these ***First*** Amendment constitutional questions is to interpret the 1992 Cable Act to require only the minimum amount of price regulation required to make rates "reasonable" under Fifth Amendment. ***See Bell Atlantic v. FCC***, Nos. 92-1619 ***et al.,*** (D.C. Cir. June 10, 1994), ***slip op***. ("Within the bounds of fair interpretation, statutes will be construed to defeat administrative orders that raise substantial constitutional questions.") In the cost-of-service context, this means setting rates at the very top of the zone of reasonableness. In this regard, the ***Bell Atlantic*** court noted that the presence of "substantial constitutional questions [will] override our customary deference to the Commission's interpretation of its own authority."

rate that is still a "reasonable" rate, within the bounds of the FCC's expert ratemaking discretion, under the Fifth Amendment.

III. THE COMMISSION SHOULD REJECT BELL ATLANTIC'S CONTRIVED "REGULATORY PARITY" ARGUMENTS.

Bell Atlantic continues to beat the drum of "regulatory parity" between cable and telephone, with no apparent recognition of the business, economic, and legal differences that remain between the two industries.[28] Bell Atlantic here complains about the differences in treatment between telephone and cable in connection with (a) the price cap systems applicable to the two industries and (b) the somewhat greater flexibility Bell Atlantic perceives cable to have regarding marketing customer premises equipment (CPE).[29] Both of these differences, however -- along with many others, not strictly within the purview of Bell Atlantic's petition -- are fully justified based on the continuing, significant differences between the two industries.

Bell Atlantic's chief concern about the price cap system for cable companies is that it does not include a "sharing" mechanism.[30] In the telephone context, price caps were adopted as a means of liberalizing the traditional rate-of-return regulation to which local exchange carriers had been subject. In that context, the Commission concluded that it was reasonable, based on its sixty years of experience regulating telephone companies under

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[28] Bell Atlantic Petition at 2-3.

[29] Bell Atlantic Petition at 3-5.

[30] *Id.* at 3-4.

rate-of-return principles, to include in the price cap plan some limited constraints based on the prior form of regulation. This is what the sharing mechanism in the local exchange carriers' price cap plan represents.

The situation with cable is totally different. The Commission has limited experience applying any form of cost-based ratemaking to cable. Indeed, in the regulatory scheme the Commission has adopted, cost-based regulation is relegated to the role of a "backstop" mechanism if the generally applicable benchmark system does not work for a particular operator. Under this regulatory scheme, it is anticipated that most cable operators will never have their individual costs reviewed at all, much less reviewed with a particular earnings level in mind. As a result, there is no policy basis for grafting a rate-of-return based sharing mechanism onto cable's version of price caps.[31]

Bell Atlantic's second concern relates to cable operators' ability, under the Commission's rules, to include certain CPE costs in promotional offerings.[32] But the differences between CPE and telephone CPE are so numerous that any suggestion that

[31] Bell Atlantic's claim that it is seeking "regulatory parity" with cable is, of course, utterly disingenuous. This is indicated, for example, by its curious silence on the issue of benchmark regulation. If Bell Atlantic actually believed that cable regulation was unfairly "superior" to telephone regulation, then presumably it would support a regulatory approach for telephone under which it would face massive, across-the-board price reductions for all its services, based on what the Commission determined to be a typical percentage rate reduction for telephone companies facing competition for particular services (such as intraLATA toll, special access and/or high capacity private line, or Centrex services). Bell Atlantic would presumably also be willing to accept a regulatory regime in which a single customer complaint can trigger the obligation either to lower rates for all customers by more than one-sixth of revenues, or file a full-blown cost-of-service case, on thirty days' notice.

[32] Bell Atlantic Petition at 5.

"parity" is required in this area should be rejected out of hand. To name but a few, in the telephone industry, CPE was historically developed and sold by affiliates of the firms providing the service, while in the cable industry, traditionally equipment vendors have not been affiliates of operators; in the telephone industry, the Commission has for more than a decade required standardized interfaces so that all manufacturer's equipment can be made interoperable with the telephone network, while in the cable industry no such standards have been required; and in the telephone industry, CPE is deregulated, while under the Commission's rate regulation rules for cable, CPE is generally to be provided at "actual cost," ***i.e.,*** at a regulated rate. In these circumstances, there is no basis for Bell Atlantic's claim that any sort of "parity" regarding CPE is appropriate.[33]

CONCLUSION

The Commission should reconsider its interim cost-of-service rules by removing the presumption against intangible assets in rate base, by recasting the burden of proof of the reasonableness of rates from cable operators to those challenging the rates, and by

[33] Here again, true "parity" -- a requirement that Bell Atlantic and other telephone companies provide CPE at "cost" as defined on an FCC form -- would not, in all likelihood, meet with Bell Atlantic's approval.

clarifying that in all cases the objective of a cost-of-service rate review will be to establish the highest rate for cable services that is reasonable under the Fifth Amendment. The FCC should, however, reject Bell Atlantic's request to inject inapt notions of "regulatory parity" into the process of regulating cable operators' rates.

Respectfully Submitted,

By: ______________________

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June 16, 1994

Declaration

I, Colleen Millsap, hereby declare, under penalty of perjury, that the following is true and correct to the best of my knowledge, information, and belief:

1. I am Chief Financial Officer of Benchmark Communications, L.P. I am also a Certified Public Accountant. Prior to holding my current position, I was employed by Hoffman, Dykes and Fitzgerald, P.C. In that capacity, I was involved in reviewing and evaluating a number of cable system acquisitions. This declaration is based on my experience in cable industry financial matters.

2. Cable systems generally do not produce steady "book" earnings over the course of their operation. To the contrary, in early years of system operation, high investment levels and low subscribership leads to significant "book" losses and low earnings. In later years of system operation, increased penetration and the "book" depreciation of original investment leads to higher "book" earnings levels. Investors considering cable properties understand this situation and expect to receive an appropriate return on their investment, including compensation for long periods with no return paid on their investment at all.

3. When a cable system is purchased by another cable system, the sale price is generally based on multiples of the expected cash flow of the system being sold. Factors which affect the precise multiple of cash flow for which a system will sell include the buyer's view of operational efficiencies and improvements that could be added to the system and the likelihood of significant growth in the subscriber base that the buyer anticipates (whether through population growth, additional system build-out, or improved marketing and service).

4. Cable system cash flow is, generally, approximately equal to one-half of system revenues. Although this figure will vary from system to system, this is a generally accurate rule that is used in evaluating the prospective financial performance of a cable system being considered for acquisition.

5. The result of this relationship between revenue and cash flow is that, as a general rule, if expenses are held constant, a $1.00 decline in revenue will result in a $1.00 decline in cash flow. Because cash flow is about one-half of revenue, however, a 1 percent decline in revenue will result in a 2 percent decline in cash flow, again, with expenses held constant.

Colleen M Millsap

Colleen Millsap

CERTIFICATE OF SERVICE

I, Frederick W. Giroux, do hereby certify that a copy of the foregoing document was mailed, first-class mail, postage-prepaid, this 16th day of June, 1994, to the following:

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*A copy of the foregoing document has also been hand-delivered.